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In Our Opinion...

*The Newsletter of the AICPA Auditing Standards Division**

Volume 10 Number 3

December 1994

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"AUDIT RISK ALERT" SERIES ISSUED

The AICPA has issued its annual *Audit Risk Alert* series that provides auditors with overviews of current economic, industry, and professional developments that may affect the audits they perform this year. These alerts can help auditors control audit risk by focusing their attention on areas that may require special audit consideration and increase audit efficiency by giving them concise and relevant information to help them understand how current developments might impact their clients. The risk alert series consists of *Audit Risk Alert—1994* (Product No. 022141CL) which describes matters of general interest, 18 industry-specific audit risk alerts that cover developments in a wide variety of industries and the *Compilation and Review Alert—1994* (Product No. 060668CL).

Following is an overview of the key subjects discussed in *Audit Risk Alert—1994*:

Implications of the Current Economic Environment

Discusses the current economic environment and rising interest rates and whether: 1) appropriate market rates are used to determine certain financial statement amounts, 2) assets, particularly intangibles, are valued properly, and 3) there is an increased risk of material misstatement in an entity's financial statements.

New Auditing and Attestation Pronouncements

Provides an overview of Statement on Auditing Standards (SAS) No. 73, *Using the Work of a Specialist*, Statement on Standards for Attestation Engagements (SSAE) No. 3, *Compilation Attestation*, and several new auditing interpretations.

Audit Problems to Watch For

Discusses numerous problems auditors should be aware of related to fraud detection, passed audit adjustments, analytical procedures, confirmations, faxes as audit evidence, legal letters and several developments related to the role computers play in an audit.

Audit Communication and Reporting Issues

Provides reminders about auditors' reports containing going-concern explanatory paragraphs, dual-dating of reports and reaudit engagements.

Recurring Peer and Quality Review Comments

Includes certain reminders for auditors based on frequently recurring peer and quality review letters of comment.

Lessons from Litigation

Discusses lessons learned from litigation, including client acceptance and continuance policies.

New GAAP Requirements

Provides an update on new accounting standards in the GAAP hierarchy and their related audit implications. Discussions focus on, among other things, derivatives, contributions received and made, investments in securities and advertising costs.

Accounting Issues

Provides an overview of several accounting issues, including restructuring charges caused by downsizing, loan provisions and environmental matters.

Accounting Pronouncements Soon to Be Issued

Discusses upcoming generally accepted accounting principles including impairment of long-lived assets and disclosure of risks and uncertainties.

Following is a list of the 1994 industry-specific audit risk alerts available, product numbers are shown in parenthesis:

- Agribusiness (No. 022151CL)
- Banks and Savings Institutions (No. 022146CL)
- Casinos (No. 022150CL)
- Construction Contractors (No. 022156CL)
- Credit Unions (No. 022147CL)

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- Employee Benefit Plans (No. 022131CL), issued June 1994
- Federal Government Contractors (No. 022153CL)
- Finance Companies (No. 022154CL)
- Health Care (No. 022161CL)
- High-Technology Enterprises (No. 022152CL)
- Insurance Companies (No. 022145CL)
- Investment Companies (No. 022143CL)
- Not-for-Profit Organizations (No. 022132CL), issued June 1994
- Oil and Gas Producers (No. 022148CL)
- Public Utilities (No. 022155CL)
- Real Estate Companies (No. 022149CL)
- Securities (No. 022144CL)
- State & Local Governments (No. 022130CL), issued June 1994

Copies of the alerts are available from the AICPA Order Department at 1-800-TO AICPA. Price: \$10 each for *Audit Risk Alert—1994* and *Compilation and Review Alert—1994*

for members, \$11 each for nonmembers; \$6.50 each for the industry alerts for members, \$7 each for nonmembers. (The risk alert series is also included in the loose-leaf service for audit and accounting guides.) The *Audit Risk Alert—1994* is also available in WordPerfect electronic format, \$10 each for members, \$11 each for nonmembers.

In addition, the following two new self-study courses are available:

- *Auditing Update: A Study Guide to the Audit Risk Alert—1994* (Product No. 730109), which will be available January 1, 1994. Recommended CPE Credit: 4 hours. Price: \$49.
- *Compilation and Review Update: A Study Guide to the Compilation and Review Alert—1994* (Product No. 730108), which will be available February 1, 1994. Recommended CPE Credit: 2 hours. Price: \$35.

The self-study courses are available from both the AICPA Order Department (1-800-TO AICPA) and state CPA societies.

TECHNICAL PLAN HIGHLIGHTS

NEW TASK FORCES

Auditing Investments Task Force (Staff Aide: JEANNE SUMMO). The Auditing Investments Task Force was formed to revise AU Section 332, *Long Term Investments*, and the Interpretation thereof, "Evidential Matter for the Carrying Amount of Marketable Securities," to focus on the auditor's responsibility in auditing investments (including derivatives) and to be consistent with the guidance in Financial Accounting Standards Board Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. The task force would develop guidance for auditors in obtaining evidential matter to corroborate the existence, ownership, amortized cost, fair value and classification of investments as well as the related treatment of gains and losses attributable to such investments. The task force held its first meeting on August 31, 1994 to address the above issues. The next task force meeting is scheduled for December 7, 1994.

SAS TASK FORCES

Analytical Procedures Task Force (ERIC NICELY). The task force will consider certain issues related to SAS No. 56, *Analytical Procedures*, to determine whether the standard needs to be revised. The task force would consider whether to expand SAS No. 56 to provide additional guidance for practitioners to perform analytical procedures as part of their substantive tests, including when the use of analytical procedures is appropriate, cautions regarding use, and the effectiveness of different analytical techniques. The task force will evaluate how analytical procedures may assist in the detection of fraud and how closely analytical procedures should be tied to the audit risk model, including whether expectations should be developed. The task force will also make recommendations for topics to be included in an Auditing Procedure Study (APS) on analytical procedures. (APSs provide practitioners with nonauthoritative practical assistance concerning auditing procedures.) At the June 1994 meeting, the ASB decided that the standard should not be revised at this time. However, the ASB requested the task force to evaluate whether paragraphs 5, 20 and 21 of SAS

No. 56 need revision. At the October 1994 ASB meeting, the ASB agreed not to make any amendments to SAS No. 56. The task force will, however, develop additional guidance in the form of an APS.

Auditing "Soft" Accounting Information Task Force (JUDITH SHERINSKY). The task force is examining existing and proposed accounting standards that generate "soft" financial statement information to evaluate the auditability of the information and to determine what additional guidance auditors may need to audit this information. The task force has been considering the Public Oversight Board's (POB's) recommendation that the ASB revise the auditor's standard report to make the prospective nature of certain accounting estimates clear and to indicate that estimated results may not be achieved. At the October 1994 ASB meeting, the ASB voted against implementing the POB's recommended report revision because (1) a generic caveat in the auditor's standard report does not provide enough information about an entity's problematic estimates, (2) the caveat could imply that the auditor is providing a lower level of assurance on the estimates than on other elements in the financial statements, and (3) the proposed SOP, "Disclosure of Certain Significant Risks and Uncertainties," will require that financial statements disclose that the preparation of financial statements involves the use of estimates and also disclose additional information about certain significant estimates. If these disclosures are included in the financial statements, there would seem to be no need to repeat them in the auditor's report.

Electronic Evidence Task Force (JANE MANCINO). The task force is considering whether existing guidance on evidential matter in the audit and attest standards is appropriate given that a significant amount of evidential matter is now electronic in nature. The task force will evaluate how an auditor's responsibility for the detection of material misstatements, including fraud, in the financial statements may be affected by electronic evidence. Finally, the task force will consider the need for nonauthoritative guidance for auditors relating to electronic evidence. The task force is developing proposed revisions to SAS No. 31, *Evidential Matter*.

Fraud (JANE MANCINO). The task force will consider clarifying the auditor's responsibility for the detection of fraud, as described in SAS No. 53, *The Auditor's Responsibility to Detect and Report Errors and Irregularities*. In addition, the task force is considering revising factors that may indicate increased risk of management fraud and providing separate indicators of employee fraud such as defalcations. Based on the results of the task force's considerations, the task force will evaluate whether any need to revise the auditor's report exists. The task force presented issues to the ASB at its October 1994 meeting. The task force will bring a revised section of SAS No. 53 on the auditor's responsibility to detect fraud to the ASB at its February 1995 meeting.

Internal Control Guidance (ERIC NICELY). A task force was formed to propose necessary revisions to SAS No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit*, to reconcile the SAS with the Committee of Sponsoring Organizations (COSO) of the Treadway Commission's Report titled *Internal Control—Integrated Framework*. At the June 1994 ASB meeting, a proposed revision to SAS No. 55 was balloted for exposure. The proposed revision will be included in an exposure draft SAS/SSAE which will include standards that are being revised to conform with the COSO Report. The exposure draft is expected to be issued in December 1994.

SAS No. 59 Guidance (JUDITH SHERINSKY). The task force is considering issues related to SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, to determine whether there is a need for additional guidance in the form of amendment or interpretation of SAS No. 59. A proposed footnote to paragraph 13 of SAS No. 59, prohibiting the use of conditional language in the auditor's conclusion about an entity's ability to continue as a going concern, will be included in the Omnibus SAS/SSAE — 1995, expected to be issued in January 1995. At the October 1994 ASB meeting, the task force presented guidance for an auditor who is asked to reissue a report on financial statements and eliminate the going-concern explanatory paragraph that existed in the original report. Such requests usually arise after a situation giving rise to substantial doubt about the entity's ability to continue as a going concern has been resolved, for example, after the entity obtains financing. The ASB determined that the guidance should be issued in the form of an interpretation of SAS No. 59 and will require that the auditor (1) audit the event or transaction that prompted the client's request to reissue the report without the going-concern explanatory paragraph, (2) reassess the going-concern status of the entity at the date of reissuance, reconsidering factors described in paragraphs 6 through 11 of SAS No. 59, and (3) perform the procedures in paragraph 12 of AU Section 560, *Subsequent Events*, when determining whether to reissue the report without a going-concern explanatory paragraph.

SAS No. 68 Revision (A. LOUISE WILLIAMSON). A task force was formed to consider revisions to SAS No. 68, *Compliance Auditing Applicable to Governmental Entities and Other Recipients of Federal Financial Assistance*, as a result of guidance in SOP 92-7, *Audits of State and Local Governmental Entities Receiving Federal Financial Assistance*, SOP 92-9, *Audits of Not-for-Profit Organizations Receiving Federal Awards*, and the Audit and Accounting Guide, *Audits of State*

and Local Governmental Units. The task force also considered the effect of proposed revisions to the General Accounting Office's (GAO's) *Government Auditing Standards* and possible revisions to the Single Audit Act of 1984 resulting from studies conducted by the GAO and the President's Council on Integrity and Efficiency. At the December 1993 ASB meeting, the ASB agreed to ballot the document prepared by the task force for issuance as an exposure draft SAS. The exposure draft SAS was issued May 12, 1994. The comment deadline ended July 29, 1994. The task force has evaluated the comment letters received and presented its recommendations to the ASB at its November 1994 meeting. At the November 1994 ASB meeting, the ASB voted to ballot the document for issuance as a final SAS. A final SAS will be issued in the first quarter of 1995.

SSAE TASK FORCES

Agreed-Upon Procedures (A. LOUISE WILLIAMSON). The Agreed-Upon Procedures Task Force is considering amendment or expansion of the performance and reporting guidance in professional standards dealing with agreed-upon procedures engagements. The task force is considering guidance concerning the practitioner's reporting responsibility for both findings and assurances in such engagements. The task force is also considering whether internal auditors may be used in agreed-upon procedures engagements and what effect the use of internal auditors would have on agreed-upon procedures reports. In addition, the task force has updated the related issues paper that was presented to the ASB in June 1990 identifying all instances in the professional standards where negative assurance based on agreed-upon procedures is permitted. At the August 1994 ASB meeting, the ASB agreed to ballot two documents (one SAS, one SSAE) prepared by the task force for issuance as exposure drafts. The exposure drafts were issued October 28, 1994, the comment deadline is January 31, 1995.

Forecasts and Projections (LINDA VOLKERT/DAN GUY). The Forecasts and Projections Task Force monitors and addresses problems encountered in implementing the guidance in the *Statement on Standards for Accountants' Services on Prospective Financial Information, Financial Forecasts and Projections*. An updated AICPA Audit and Accounting Guide, *Guide for Prospective Financial Information*, was published in March 1993. The task force is in a monitoring stage and a meeting is not scheduled at this point in time.

Reporting on Internal Control (A. LOUISE WILLIAMSON). In May 1993, the ASB issued SSAE No. 2, *Reporting on an Entity's Internal Control Structure Over Financial Reporting* (Product No. 023056), which superseded SAS No. 30, *Reporting on Internal Accounting Control*. The task force has recommended certain revisions to SSAE No. 2 to conform with the Committee of Sponsoring Organizations of the Treadway Commission's Report, *Internal Control—Integrated Framework*. The ASB voted in April 1994 to ballot a proposed revision to SSAE No. 2 for issuance as an exposure draft. At the June 1994 ASB meeting, the ASB determined to include the proposed revisions to SSAE No. 2 in an exposure draft which will include standards that are being revised to conform with the Committee of Sponsoring Organizations

of the Treadway Commission's Report, *Internal Control—Integrated Framework*. An exposure draft SAS/SSAE is expected to be issued in December 1994.

The ASB requested that the task force review SAS No. 58, *Reports on Audited Financial Statements*, to determine whether a revision is necessary to the auditor's standard report to include a statement about the auditor's responsibility for the internal control structure in a financial statement audit. The task force's proposed revision to SAS No. 58 was discussed at the October 1994 ASB meeting. The ASB recommended the task force discontinue its project to revise the auditor's standard report to describe the auditor's responsibility for the internal control structure in an audit. The ASB believes effectively communicating this would be difficult because the extent of the auditor's procedures on the internal control structure varies in each engagement.

SEC Auditing Practice (JANE MANCINO). The task force is revising the guidance in the 1987 exposure draft SSAE, "Examination of Management's Discussion and Analysis." The task force has also developed a sample letter for auditors when the criteria in paragraphs 4 through 7 of SAS No. 72, *Letters for Underwriters and Certain Other Requesting Parties*, for issuance of a comfort letter, have not been met. At its August 1994 meeting, the ASB voted to expose amendments to SAS No. 72. The exposure draft was issued October 28, 1994, the comment period ends January 31, 1995. The ASB will discuss issues related to Management's Discussion and Analysis (MD&A) at its December 1994 meeting.

APS TASK FORCES AND COMMITTEES

Audit of Small Businesses (JEANNE SUMMO). The Auditing Procedure Study (APS) titled *Audits of Small Businesses* is being revised to reflect SAS Nos. 53-62. The chapters on evaluating internal controls and on performing analytical procedures will be revised to discuss the implementation of SAS Nos. 55 and 56, *Consideration of the Internal Control Structure in a Financial Statement Audit* and *Analytical Procedures*, respectively, in small business audits. Other changes will be made throughout the study to provide guidance that is consistent with recently-issued standards. The revised APS will be available in 1995.

Audit Sampling (JEANNE SUMMO). A task force is developing an APS to replace the Audit and Accounting Guide, *Audit Sampling*. The APS updates the guide for recently issued SASs. A final APS is expected to be issued in the first quarter of 1995.

Computer Auditing Subcommittee (JANE MANCINO). The Computer Auditing Subcommittee published in June 1994 an APS titled *Auditing With Computers*. The APS updates the guidance in the Audit and Accounting Guide, *Computer-Assisted Audit Techniques*. Another APS, *Auditing in Common Computer Environments*, has been approved for

publication. It addresses the possible effects of certain computer environments, such as local area networks, on the auditor's consideration of the internal control structure in a financial statement audit. The Computer Auditing Subcommittee is also currently drafting the following two APSs:

- The first APS, *Auditing in a Client/Server Environment*, describes client/server computing and its possible effects on the financial statement audit. This APS is expected to be issued in early 1995.
- The second APS is a joint project with the Canadian Institute of Chartered Accountants (CICA) describing Electronic Data Interchange (EDI) and Image Processing and its possible effects on the financial statement audit. This APS is currently being developed.

SAS No. 70 Auditing Procedure Study (JUDITH SHERINSKY). The task force is developing an APS that will provide guidance to auditors on implementing SAS No. 70, *Reports on the Processing of Transactions by Service Organizations*. The APS will provide guidance to service auditors on performing and reporting on a service auditor's engagement and to user auditors on using a service auditor's report in the audit of the financial statements of a user organization. An example of a service organization is a bank trust department that invests and holds assets for employee benefit plans. At the October 1994 Audit Issues Task Force meeting, the task force presented interpretations of SAS No. 70 that provide guidance on (1) reporting the results of tests of operating effectiveness, and (2) service organizations that use the services of other service organizations (subservice organizations). The task force expects to issue the interpretations and the APS in the first quarter of 1995.

OTHER TASK FORCES AND COMMITTEES

Accounting and Review Services Committee (JUDITH SHERINSKY). The Accounting and Review Services Committee will meet on December 16, 1994 to discuss the pros and cons of establishing a level of service below a compilation.

The members of the 1994-1995 ARSC are:

Wanda Lorenz, Chair, *Lane Gorman Trubitt, LLP*
Bruce S. Botwin, *Cogen Sklar Levick*
Patrick S. Callahan, *Frederick B. Hill & Company, PC*
Peter Nathan Chase, *Chase and Associates CPAs, PC*
D. Ronald Davis, *Thomas Leger & Co., LLP*
William L. Hancock, *Mayer Hoffman McCann*
Gary Steven Nelson, *Nelson Harrigan Fladwood & Co.*

Audit Issues Task Force (JEANNE SUMMO). The Audit Issues Task Force meets monthly to assist the ASB Chair and the Auditing Standards Division staff with the technical review of audit issues to determine if those issues require ASB review.

Environmental Issues Task Force (JUDITH SHERINSKY). The task force is drafting a chapter titled, "Auditing Environmental Remediation Liabilities" that will be included in the Accounting Standards Division's proposed Audit and Accounting Guide, *Environmental Remediation Liabilities* (the guide). The task force will also evaluate, on an on-going basis, the need for auditing or attestation guidance related to environmental matters and monitor related activities of other standard-setting bodies. The task force has completed a draft of the chapter and will present issues that have arisen in the development of the guidance at the December 1994 ASB meeting.

Joint Task Force on Quality Control Standards (JAMES CAREY). The task force was formed to consider revisions to the Statement on Quality Control Standards and the interpretations and develop specific recommendations. The task force will also consider whether Section QC90 of AICPA *Profes-*

sional Standards, "Quality Control Policies and Procedures for CPA Firms," should be revised and develop specific recommendations for revisions in those documents. The task force presented its tentative recommendations to the AICPA practice monitoring committees at their September 1994 meetings. The task force also plans to present its recommendations at the February 1995 ASB meeting.

9000 Review Task Force (ERIC NICELY). The task force has prepared a proposed Omnibus SAS/SSAE — 1995 to revise various sections of the authoritative literature. The task force also is developing several auditing interpretations. The task force receives various assignments on a continuous basis from Division staff and the ASB's Audit Issues Task Force. The task force met in October 1994 to discuss various issues it has been assigned.

REMAINING 1994 ASB MEETING DATE

December 13-14, 1994
(New York, NY)

For information about the ASB meeting agenda, call the AICPA toll free at 1-800-TO-AICPA.

1995 ASB MEETING DATES

February 7-9, 1995
(Long Boat Key, FL)

June 6-8, 1995
(New York, NY)

November 14-16, 1995
(New York, NY)

April 4-6, 1995
(New York, NY)

August 8-10, 1995
(To Be Determined)

December 12-14, 1995
(New York, NY)

October 10-12, 1995
(New York, NY)

For information about the ASB meeting agenda, call the AICPA toll free at 1-800-TO-AICPA.

AUDITING STANDARDS DIVISION STAFF

Dan M. Guy	Vice President, Auditing	212/596-6214
Jane M. Mancino	Technical Manager	212/596-6029
J. Eric Nicely	Practice Fellow	212/596-6028
Judith M. Sherinsky	Technical Manager	212/596-6031
Jeanne M. Summo	Technical Manager	212/596-6030
A. Louise Williamson	Technical Manager	212/596-6034
Sherry P. Boothe	Administrative Secretary	212/596-6032
Jacqueline E. Walker	Administrative Assistant	212/596-6033

NEW DIRECTOR APPOINTED

The Auditing Standards Division is proud to announce the recent appointment of J. Louis Matherne as Director of Auditing Standards. Louis joins the AICPA from Grant Thornton, where he was a senior audit manager in the firm's National Accounting and Auditing Group in New York. In this position, he was responsible for providing technical support and direc-

tion to the firm's partner and manager group, developing and presenting continuing education for the firm's continuing education program, and writing internal accounting and auditing guidance. Louis has extensive industry experience with an emphasis in the financial institutions area. Louis will begin his role as Director in December 1994.